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SENATE REPUBLICAN POLICY COMMITTEE

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President's Budget Message: Make Tax Relief Permanent!

Executive Summary

- On February 5, 2007, President Bush submitted his Fiscal Year 2008 Budget request to Congress. In it, he advocates a disciplined approach to spending, combined with strong revenues that have surged under the existing pro-growth tax policies, as the best way to drive down the deficit and produce a surplus in 2012.
  - The President's budget makes clear that the key to continued, long-term economic growth is making permanent the tax relief enacted in 2001 and 2003.
- If permanence is not achieved, it would place in jeopardy the successful economic trend America is experiencing, and it would also saddle American taxpayers with the largest tax increase in the nation's history.
- *Every* taxpayer who paid income taxes will get relief this year due to the tax cuts enacted by the Republican Congresses in 2001 and 2003.
- While some opponents continue to dispute the efficacy of tax relief, even the non-believers must have a difficult time arguing with *facts* that show that the economy is strong and continues to grow.
- Current tax policies are providing the necessary funding for the government. Tax receipts were up almost 12 percent in FY 2006, after rising by 14.6 percent in FY 2005.
  - In 2006, taxes measured 18.4 percent of GDP. This historic figure of around 18 percent seems to represent a good balance that allows for sufficient revenues without hurting the economy.
- The tax system is even more progressive than before the 2001 and 2003 tax provisions were enacted. This means that the tax relief has shifted a larger share of the individual income taxes paid to higher-income taxpayers.
  - In 2006, the projected tax share for lower-income taxpayers will *fall*, while the tax share for higher-income taxpayers will *rise*, hardly indicative of a tax system that is biased against low-to-middle-income taxpayers.
- *All* Americans who pay income tax will experience a tax increase if the 2001 and 2003 tax provisions are not made permanent.

Introduction

On February 5, 2007, President Bush submitted his Fiscal Year 2008 Budget request to Congress. In it, he advocates a disciplined approach to spending, combined with strong revenues that have surged under the existing pro-growth tax policies, as the best way to drive down the deficit and produce a *surplus* in 2012.[1] The President's budget makes clear that the key to continued, long-term economic growth is making **permanent** the tax relief enacted in 2001 and 2003.

If permanence is not achieved, it would place in jeopardy the successful economic trend America is experiencing, and it would also saddle American taxpayers with the *largest* tax increase in the nation's history. Thus, Congress can't afford to let the tax relief expire. The provisions that are in danger of expiring include: the 10-percent individual income tax bracket; reduction in individual income tax rates above the 15 percent rate bracket; reduction of marriage penalties, 15-percent rate bracket, and the earned income tax credit; increase in the child tax credit to $1,000; expansion of the partially refundable additional child tax credit; increase in the child and dependent care tax credit; simplification of the rules for determining income for the earned income tax credit; small business expensing; lower tax rate on capital gains and dividend income; and estate tax repeal.

Tax Relief Has Been Good for All American Taxpayers

Every taxpayer who paid income taxes will get relief this year due to the tax cuts enacted by the Republican Congresses in 2001 and 2003. Consider the following Treasury Department data:

- A family of four earning $40,000 will receive average tax relief of $2,010 per year.
- More than 5 million individuals and families will see their income tax liabilities eliminated completely. In addition, low-income families will also benefit from provisions that make the child tax credit refundable for more families and that reduce the marriage penalties.
- 44 million families with children will receive average tax relief of $2,493 per year.
- 14 million elderly individuals will receive average tax relief of $2,043 per year.
- 25 million small business owners will receive average tax relief of $3,641 per year.[2]

[1] President's Budget, released February 5, 2007, found at http://www.whitehouse.gov/omb/budget/fy2008/.
[2] Department of Treasury, Office of Tax Policy.

The following table illustrates the smaller tax bills that millions of Americans enjoy due to the 2001 and 2003 tax relief:

Figure 1: 2001 and 2003 Tax Relief Continues to Benefit Millions of Americans

	Total Returns Benefiting from the 2001 & 2003 Tax Acts (thousands)	Specific Provisions of the Acts					Total Returns with Business Income Benefiting from the 2001 & 2003 Tax Acts (thousands)
		Total Returns Benefiting from the 10-Percent Bracket (thousands)	Total Returns Benefiting from the Lower Top Tax Rates (thousands)	Total Returns Benefiting from the Marriage-Penalty Relief (thousands)	Total Returns Benefiting from the Increased Child Tax Credit (thousands)	Total Returns Benefiting from the Lower Dividend & Capital-Gains Tax Rates (thousands)	
United States	107,387	94,707	26,389	31,972	27,166	23,068	24,956
Alabama	1,503	1,288	280	454	443	281	334
Alaska	271	246	73	80	62	60	71
Arizona	1,961	1,727	453	594	514	407	420
Arkansas	883	759	140	281	254	161	211
California	12,658	11,079	3,554	3,630	3,050	2,893	3,265
Colorado	1,747	1,564	478	551	421	400	497
Connecticut	1,394	1,239	465	425	318	358	336
Delaware	331	297	90	97	83	73	63
Florida	6,553	5,717	1,442	1,815	1,636	1,337	1,541
Georgia	3,042	2,638	709	875	848	621	732
Hawaii	497	448	120	145	117	105	126
Idaho	474	418	81	168	130	93	138
Illinois	4,681	4,143	1,270	1,391	1,189	1,047	1,041
Indiana	2,295	2,057	494	740	612	471	484
Iowa	1,084	979	212	368	283	221	293
Kansas	986	879	207	332	260	206	253
Kentucky	1,387	1,221	257	453	371	272	310
Louisiana	1,441	1,229	261	396	424	259	322
Maine	500	449	95	158	124	100	135
Maryland	2,236	2,000	731	635	542	537	496
Massachusetts	2,564	2,299	821	751	553	633	632
Michigan	3,662	3,271	930	1,163	936	796	754
Minnesota	1,993	1,805	530	648	482	456	500
Montana	336	297	54	107	84	64	108
Mississippi	893	754	136	244	278	148	181
Missouri	2,066	1,834	429	651	541	418	460
North Carolina	3,034	2,645	623	927	846	601	711
North Dakota	242	219	41	79	60	48	76
Nebraska	650	584	127	214	168	132	173
Nevada	925	829	225	257	231	194	185
New Hampshire	536	486	147	174	127	125	130
New Jersey	3,416	3,004	1,138	1,015	811	858	749
New Mexico	642	559	124	183	171	121	145
New York	6,949	6,101	1,975	1,804	1,668	1,558	1,605
Ohio	4,427	3,991	1,047	1,214	1,032	902	883
Oklahoma	1,155	1,005	199	378	319	220	303
Oregon	1,299	1,157	292	414	325	274	336
Pennsylvania	4,676	4,185	1,106	1,443	1,160	1,002	943
Rhode Island	413	372	110	119	96	91	95
South Carolina	1,464	1,275	278	424	413	275	313

	Total Returns Benefiting from the 2001 & 2003 Tax Acts (thousands)	Specific Provisions of the Acts					Total Returns with Business Income Benefiting from the 2001 & 2003 Tax Acts (thousands)
		Total Returns Benefiting from the 10-Percent Bracket (thousands)	Total Returns Benefiting from the Lower Top Tax Rates (thousands)	Total Returns Benefiting from the Marriage-Penalty Relief (thousands)	Total Returns Benefiting from the Increased Child Tax Credit (thousands)	Total Returns Benefiting from the Lower Dividend & Capital-Gains Tax Rates (thousands)	
South Dakota	284	255	46	92	73	55	89
Tennessee	2,075	1,814	393	636	575	402	471
Texas	7,480	6,438	1,651	2,258	2,049	1,517	1,787
Utah	805	716	152	289	223	165	212
Vermont	247	224	53	76	58	52	72
Virginia	2,924	2,595	849	908	705	690	625
Washington	2,385	2,138	637	762	587	539	551
Wisconsin	2,114	1,946	496	697	536	459	465
West Virginia	582	510	94	199	156	110	111
Wyoming	195	176	42	65	50	41	56

Source: Department of Treasury. Data is based on tax returns filed in 2005. http://www.treas.gov/offices/tax-policy/library/tax_relief_kit.pdf.

Tax Relief Has Promoted a Pro-Growth Economy and Surging Revenues

While some opponents continue to dispute the efficacy of tax relief, even the non-believers must have a difficult time arguing with *facts* that show that the economy is strong and continues to grow:

- The economy has grown at a solid 3.4 percent over the last 4 quarters. [3]
- More than 7.2 million jobs have been created since August 2003, more jobs than all of the major industrialized countries *combined*.[4]
- Labor productivity has grown at an annual rate of 3 percent over the last five years. [5]
- The unemployment rate remains a low 4.5 percent, below the 5.1 percent average for 2005, and below the average of each of the past four decades.[6]
- Real wages rose 1.7 percent during 2006.[7]
- Real after-tax income per person has risen 9.7 percent, an *extra* $2,499 per person, since the President took office. [8]

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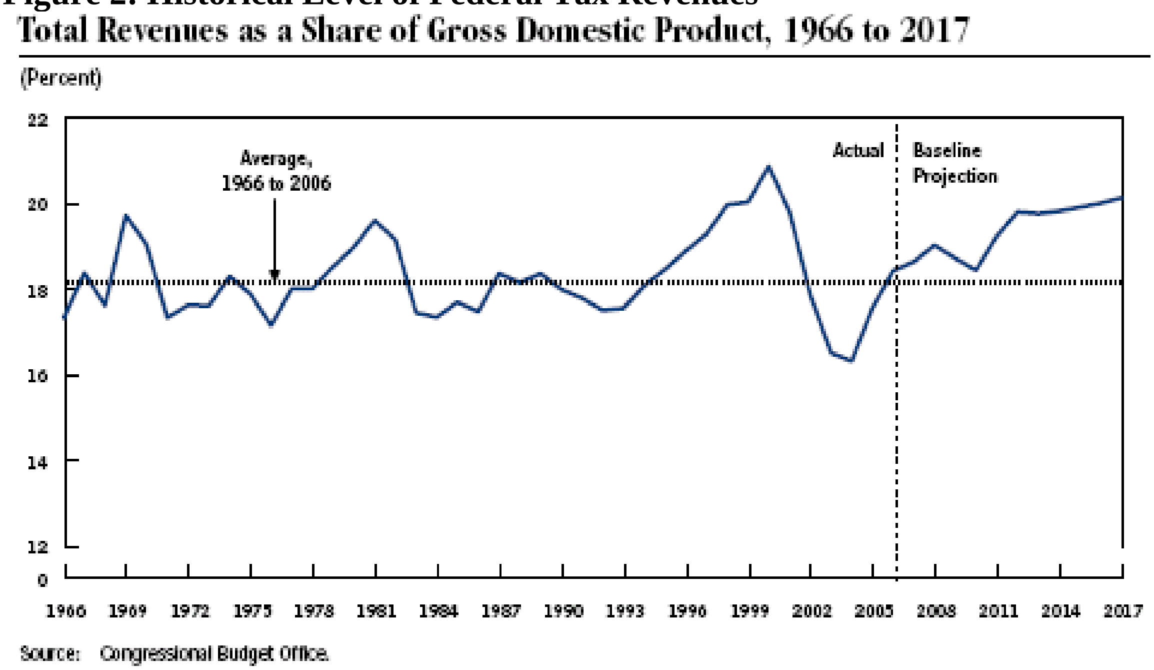
[3] Department of Treasury, Press Releases, Economic Update February 2, 2007, found at http://www.treas.gov/press/releases/reports/treasuryeconupdate%202.2.07.pdf.
[4] White House, State of the Economy Overview, January 2007, found at http://www.whitehouse.gov/infocus/economy/2007/#section2.
[5] Department of Treasury, Press Releases, Economic Update February 2, 2007, found at http://www.treas.gov/press/releases/reports/treasuryeconupdate%202.2.07.pdf.
[6] White House, State of the Economy Overview, January 2007, found at http://www.whitehouse.gov/infocus/economy/2007/#section2.
[7] Department of Treasury, Press Releases, Economic Update February 2, 2007, found at http://www.treas.gov/press/releases/reports/treasuryeconupdate%202.2.07.pdf.

Current tax policies are providing the necessary funding for the government. Tax receipts were up almost 12 percent in FY 2006, after rising by 14.6 percent in FY 2005.[9] Since the capital gains rate was reduced in 2003, revenues have exceeded official CBO projections by 68 percent.[10] Compared against the size of the economy, taxpayers are sending more in taxes to Washington than the post 1966-historic average of about 18.2 percent. In 2006, taxes measured 18.4 percent of GDP.[11] This figure seems to represent a good balance that allows for sufficient revenues without hurting the economy.

However, as Figure 2 below illustrates, if the tax relief is not extended, federal revenues will rapidly exceed that balanced amount, approaching **20 percent** of the nation's gross domestic product (GDP). As a result, hundreds of billions of dollars each year will be withheld from productive use in the private sector, diverted instead into the federal government's tax coffers and subsequently spent. Conversely, if the 2001 and 2003 tax cuts are made permanent, the nation's tax burden will remain in the range of its historic average over the past 40 years as a percentage of GDP, roughly **18 percent**, thereby increasing the potential for long-term economic growth.

Figure 2: Historical Level of Federal Tax Revenues



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[8] Department of Treasury, Press Releases, Economic Update February 2, 2007, found at http://www.treas.gov/press/releases/reports/treasuryeconupdate%202.2.07.pdf.

[9] Congressional Budget Office, The Budget and Economic Outlook: Fiscal Years 2008 to 2017, January 2007.

[10] American Shareholders Association, found at http://www.americanshareholders.com/blog/2007/01/cbos-capital-gains-error-now-stands-at.php.

[11] Congressional Budget Office, The Budget and Economic Outlook: Fiscal Years 2008 to 2017, January 2007.

Opponents overlook the fact that the corresponding tax hike will have devastating consequences for the economy. Less capital in the private sector will increase financing costs for American businesses, hindering their ability to make capital investments, expand their operations, and provide critical jobs. Moreover, slower economic growth — or worse, a recession — will have adverse effects on tax revenues, resulting in additional budgetary challenges for the federal government.

Tax Relief Has Made the Income Tax System More Progressive

As the figure below indicates, the tax system is even more progressive than before the 2001 and 2003 tax provisions were enacted. This means that the tax relief has shifted a larger share of the individual income taxes paid to higher-income taxpayers. In 2006, the projected tax share for lower-income taxpayers will *fall*, while the tax share for higher-income taxpayers will *rise*, hardly indicative of a tax system that is biased against low-to-middle-income taxpayers.[12] The top 1 percent of taxpayers will pay 32.4 percent of all the personal income taxes in 2006, while the bottom 50 percent will pay only 3.4 percent.

Who Pays Federal Income Taxes

Percentiles Ranked by Adjusted Gross Income (AGI)	AGI Threshold	Percentage of Federal Personal Income Tax Paid	
		With the Tax Cuts	Without the Tax Cuts
Top 1 percent	$341,773	32.4%	32.3%
Top 5 percent	$151,708	53.3%	51.6%
Top 10 percent	$111,528	65.7%	63.6%
Bottom 50 percent	< $33,705	3.4%	4.0%

Source: U.S. Department of Treasury, 2006 figures.

Tax Relief Expiration Will Cause Tax Hikes for Every American Taxpayer

All of the abovementioned economic successes will be for naught if the tax relief is not made permanent. If the tax relief is allowed to expire, the country will face a series of tax hikes totaling more than $1.6 trillion over the next 10 years,[13] collectively the *greatest tax increase in history*. According to the Treasury Department, *all* American taxpayers will experience a tax increase if the 2001 and 2003 tax provisions are not made permanent. On average:

[12] Department of Treasury, Office of Tax Policy.
[13] President's Budget, released February 5, 2007, found at http://www.whitehouse.gov/omb/budget/fy2008/.

- A family of four with two children and an annual income of $56,300 ($50,000 today) will see its taxes increase by more than $2,000 — a **132 percent higher tax bill**. A family of four with $67,600 in annual income ($60,000 today) will see its taxes increase by more than $1,800 — a **58 percent higher tax bill.** [14]
- 115 million taxpayers will see a $1,716 increase.
- 84 million women will see a $1,970 increase.
- 48 million married couples will see a $2,726 increase.
- 12 million single women with children will see a $1,062 increase.
- 17 million seniors will see a $2,034 increase.
- 26 million small business owners will see a $3,637 increase.
- More than 5 million low-income individuals and couples will <u>no</u> longer be exempt from individual income tax.[15]

Conclusion

Republicans are proud of the tax relief that they have provided for millions of American taxpayers. The tax relief has been a positive stimulus on the overall economy, while simultaneously promoting individual work, savings, and investments…all successes that <u>must</u> continue. Otherwise, if permanence is not achieved, the American people are in peril of increased taxes and a sluggish economy.

[14] U.S. Department of Treasury release available at http://www.ustreas.gov/press/releases/reports/2011taxesmillions.pdf.

[15] Department of Treasury, Office of Tax Policy. The tax increase figures assume that the following provisions of the President's tax relief expire in 2010: creation of the new 10-percent individual income tax bracket, reduction in individual income tax rates above the 15-percent rate bracket, reduction of the marriage penalties, 15-percent rate bracket, and the earned income tax credit, lowering the tax rate on capital gains and dividend income to 15 percent, increase in the child tax credit to $1,000, increase in the child and dependent care tax credit, and simplification of the rules for determining income for the earned income tax credit.